COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

GENERAL ADJUSTMENT OF ELECTRIC RATES OF KENTUCKY UTILITIES COMPANY	))	CASE NO. 8624

ORDER ON REHEARING

On April 27, 1983, the Commission granted the Kentucky Utilities Company ("K.U.") a rehearing on five issues adjudicated in the Commission's Order entered March 18, 1983, on K.U.'s general rate request. The rehearing, held on May 19, 1983, afforded K.U. the opportunity to present additional evidence in support of its position with respect to the transmission line rental expense, capitalization of overheads, antitrust legal fees, coal inventory level and a load forecasting consultant's study. Intervenors of record participated in the rehearing.

Transmission Line Rental Expense

K.U. presented additional testimony and exhibits on rehearing in support of its proposed adjustment of $1,019,215 to annualize its 500 KV transmission line rental expense. The Commission finds that this 500 KV line provides both increased service reliability and bulk power transfer capability to K.U.'s Mountain Division.

K.U.'s evidence tendered at the rehearing failed to support the cost allocation proposed for service area reliability.

Consequently, the Commission directed its staff to prepare a memorandum on this issue. The memorandum, dated June 8, 1983, was sent to all parties of record with notice that responses could be filed within 10 days. K.U.'s response consisted of an expanded discussion of the 500 KV line and three new load flow diagrams. The new load flow diagrams indicate that if K.U.'s 345/161 KV transformer at Pineville were to fail, low voltage would occur in the Pineville and Harlan service areas. The load flow diagrams also demonstrate that the addition of a 500/161 KV substation at Pocket, Virginia, would benefit K.U.'s Kentucky customers by eliminating any low voltage conditions.

The Commission is disturbed by K.U.'s failure to provide prior to the rehearing sufficient evidence to support this expense adjustment. The Commission's task of evaluating this adjustment has been complicated by K.U.'s practice of providing documentary evidence on a piecemeal basis. Based upon the evidence on rehearing, the Commission finds that K.U.'s substation located in Pocket, Virginia, benefits K.U.'s Mountain Division, but a nine-mile section of its 500 KV transmission line exclusively benefits Old Dominion Power Company, K.U.'s Virginia subsidiary. Based on these findings K.U.'s annualized transmission line rental expense should be $920,573.[1] This represents an increase of $475,147 over the $445,426 found reasonable by the Commission in its Order entered March 18, 1983.

[1]See Appendix A for calculation.

Capitalization of Overheads

The Commission's Order entered March 18, 1983, made a pro forma adjustment to reduce K.U.'s operating expenses by approximately $1.7 million to exclude certain overhead costs which should have been capitalized in accordance with the Uniform System of Accounts. In its petition for rehearing, K.U. argued that the adjustment to operating expenses should have been offset with an adjustment to increase capital which would have resulted in additional revenues of $383,937. K.U.'s sole argument on rehearing was that failure to capitalize the test year overheads expensed would result in K.U.'s inability ever to recover these costs.

The basic controversies on this issue are whether the $1.7 million in construction overheads expensed during the test period should be capitalized, and whether failure to capitalize the $1.7 million would result in a loss of revenue to which K.U. is entitled.

The Commission did not order K.U. to capitalize the $1.7 million in test period overheads expensed. If the Commission had so ordered, K.U. could argue that the treatment of this item should increase capital "...just as any increase to plant would adjust the capitalization."[2] The Commission recognized these overheads as a test period operating expense which would not recur. Due to

[2] Rehearing testimony, C. Fred Davis, controller of K.U., page 1.

the prospective change in accounting treatment the Commission made a pro forma adjustment to decrease operating expenses. The Commission found no basis for requiring K.U. to capitalize the actual test period overheads expensed. Furthermore, the Commission is of the opinion that capitalization of the test period overheads expensed would result in a double recovery of these costs. As a basis for this position the Commission cites its basic rate-making methodology, which follows:

> The rates authorized by the Commission are designed to recover operating costs to be incurred during the period in which the rates will be in effect. A historical 12-month period is the basis for projecting the costs of the period which the rates will cover, and adjustments are made to reflect known and measurable changes.
>
> Most adjustments to test period operating costs are to increase or decrease costs due to price increases or decreases, to exclude costs which are extraordinary or non-recurring, to reflect more reasonable levels of cost for specific items reported in the test period, and to capitalize costs which should not have been included in test period expenses. When the Commission finds that a test year expense should have been capitalized, it has ordered the utility to capitalize that cost and included additional capital based on the reassignment of that cost. In those instances where the Commission has allowed changes to capital, the original entries were in error and did not follow the Uniform System of Accounts and the utility was required to adjust its books retroactively to reflect appropriate plant in service and retained earnings accounts.

In its Order of March 18, 1983, the Commission found that projected operating costs would be $1.7 million less than test period costs due to a <u>change</u> in accounting treatment for certain overhead costs. The Commission did not require K.U. to capitalize the test period overhead expense because K.U. had followed its long-standing accounting procedure of reflecting those costs in operating expenses. Furthermore, the rates that were in effect during the test period had been established based upon a prior test period in which similar overhead costs had been expensed. Therefore, the test year revenues covered these expenditures.

If K.U. had revised its accounting for the construction overheads at the beginning of the test period it would have realized $1.7 million in additional earnings and its reported plant in service would have been $1.7 million greater. This same result would be achieved if the Commission were to authorize a prior period adjustment to the test year. However, K.U. contends that under generally-accepted accounting principles it cannot make a prior period adjustment under these circumstances. K.U. argues that the proper accounting entries to reverse the test period entries would be to credit current operating costs and debit the appropriate asset accounts.[3] The Commission can find no justification for these proposed accounting entries. These entries would understate current period operating expenses and overstate reported earnings.

The Commission finds that K.U. has recovered the $1.7 million in construction overheads expensed during the test period and consequently K.U. is not entitled to record these costs in asset

[3]Response to Rehearing Request, dated May 19, 1983, Item 3.

accounts and offset current operating costs as proposed in its petition for rehearing. Therefore, the Commission will affirm its Order entered March 18, 1983, with respect to capitalizing overheads.

Antitrust Legal Fees

For many years K.U. has defended numerous law suits instituted by its wholesale municipal customers and the Southeastern Power Administration ("S.E.P.A."). The purpose of the litigation is to force K.U. to wheel S.E.P.A. hydro power for the benefit of K.U.'s municipal customers. K.U. alleges that since its defense will benefit all its customers, its legal fees should be allocated to all customers. Utilizing a labor allocation, K.U. assigned 90.62 percent of these legal fees to Kentucky retail customers.

On rehearing, K.U. failed to present sufficient evidence to prove that its defense does benefit its Kentucky retail customers. K.U. did not prepare an analysis to determine if energy cost savings would accrue from dispatching the S.E.P.A. power to meet its system load. Further, no analysis was prepared to ascertain if the S.E.P.A. power could be scheduled to meet K.U.'s peak demand so as to produce capital savings through deferral of new generating capacity.

The evidence of record supports the Commission's finding that these legal fees were incurred by K.U. as a result of its wholesale sales. Since this expense arose solely from K.U.'s wholesale customers, it should be directly assigned to them.

Coal Inventory

K.U.'s test year end level of coal inventory was a 124-day supply at its 13-month average test year burn rate of 11,298 tons per day. K.U. argued on rehearing that this level was reasonable and necessary based upon the criteria set forth in Administrative Case No. 231, Contingency Plans for Emergency Procedures During an Energy Shortage, and the fact that the delivery schedule under two long-term coal supply contracts for Ghent Units 2 and 3 are beyond K.U.'s control.

The Commission finds no merit in either of these arguments. The order in Administrative Case No. 231, as its caption implies, establishes criteria to be utilized during periods of potential fuel shortages. Since such a shortage neither occurred during the test year nor is anticipated within the next 12 months, the guidelines established in Administrative Case No. 231 are inapplicable and afford K.U. no basis to exceed its optimum coal supply range of 60 to 90 days.

K.U. also claims that federal regulations in effect during the 1970's required the procurement of two long-term supply contracts for Ghent Units 2 and 3 and that these contracts restrict K.U.'s ability to control its inventory. Such excuses are unpersuasive. The two supply contracts provide only enough coal to operate Ghent Units 2 and 3 at a 47 percent capacity factor. K.U. has failed to document sufficiently its efforts to further renegotiate downward its supply contracts or to resell the coal.

It would be unfair, unjust and unreasonable to require K.U.'s customers to pay the carrying charges associated with a coal inventory of 124 days when the top end of K.U.'s optimum inventory range is 90 days. Accordingly, the Commission will affirm its Order entered March 18, 1983, with respect to K.U.'s level of coal inventory included in rate base.

Consultant's Study

The rehearing with respect to the load forecasting consultant was granted conditioned upon K.U.'s reassertion of any complaints within 10 days of a May 18, 1983, conference in Case No. 8666, An Investigation Into Alternative Load Forecasting Methods and Planning Considerations for the Efficient Provision of Electric Generation and Transmission Facilities. K.U. appeared and participated in that conference, which considered the load forecasting consultant. Since no complaints were reasserted within that period, K.U. has waived its right to a further evidentiary hearing on this issue. Accordingly, the Commission will affirm its Order entered March 2, 1983.

Since this Order on Rehearing authorizes K.U. additional revenues, the Commission will grant K.U. $52,067 over a two year period to recover its cost for the consultant's study. The Commission further finds that the load forecasting study mandated in this proceeding is closely related to the investigation to be performed in Case No. 8666 and that economies would be achieved by transferring the study to Case No. 8666.

Revenue Allocation

The revenue increase authorized by this Order on Rehearing should be allocated to the two customer classes using the greatest amount of energy, i.e., the residential class and the combined light and power class. K.U.'s cost of service study shows that each of these classes produced a rate of return lower than K.U.'s overall average rate of return. The Commission finds that the proper method of revenue allocation is an energy adder.

SUMMARY

The Commission, based upon the evidence of record and being advised, is of the opinion and finds that:

1. K.U.'s Mountain Division receives benefits from all except nine miles of a 500 KV transmission line connecting K.U.'s Pineville substation to the Tennessee-Virginia state line.

2. K.U. has failed to present sufficient evidence to support its arguments that its test year overheads should be capitalized, that its antitrust legal fees should be allocated to its Kentucky retail customers and that its test year end level of coal inventory is reasonable and proper.

3. K.U. has not reasserted any complaints regarding the load forecasting consultant within 10 days of the May 18, 1983, conference.

4. The Commission's Order entered March 18, 1983, should be modified to authorize K.U. additional expenses of $475,147 for its 500 KV transmission line rental expense and $26,034 amortization expense for the consultant's study.

5. The rates in Appendix A to the Commission's Order entered March 18, 1983, should be modified by the rates in Appendix B to produce additional revenues of $502,270 based on the adjustments in Finding No. 4 and in consideration of applicable adjustments for state and federal income taxes.

IT IS THEREFORE ORDERED that the Commission's Order entered March 18, 1983, be and it hereby is modified in accordance with Findings No. 4 and No. 5 and affirmed in all other respects.

IT IS FURTHER ORDERED that the rates in Appendix B be and they hereby are approved for service rendered by K.U. on and after the date of this Order.

IT IS FURTHER ORDERED that the load forecasting study mandated in this proceeding by Order entered March 18, 1983, be and it hereby is transferred to Case No. 8666.

IT IS FURTHER ORDERED that within 30 days of the date of this Order K.U. shall file with the Commission its revised tariff sheets setting out the rates approved herein.

Done at Frankfort, Kentucky, this 11th day of August, 1983.

PUBLIC SERVICE COMMISSION

Chairman

Katherine Randall
Vice Chairman

Commissioner

ATTEST:

Secretary

APPENDIX A

Pocket Substation Allocation

$$\text{O.D.P.} = \frac{120}{120+260} \times 4,706,130 = 1,486,146$$

$$\text{K.U.} = \frac{260}{120+260} \times 4,706,130 = 3,219,984$$

Total O.D.P. Cost Responsibility

Bulk Power Related	1,853,012	(from June 8 memo)
Nine Miles of 500 KV Line	3,114,310	(from June 8 memo)
Pocket, Va., Substation	1,486,146	
Total	6,453,468	

Total Estimated Cost of Va. facilities = 12,018,216

Assigning responsibility for $6,453,468 worth of these facilities to O.D.P. leaves K.U. responsible for $5,564,748 worth or 46.30% of the Va. plant.

To date $9,940,864 worth of the Va. plant has been completed. Using the above percentage, K.U. becomes responsible for maintaining $4,602,620 worth of this plant. (.4630 X 9,940,864 = 4,602,620.)

The monthly rental fee for this responsibility then becomes $74,217 (4,602,620 X .1935/12 = 74,217).

Annualizing this figure and the TVA rental results in an annual rental fee of $1,731,324.

[($70,060 + 74,217) X 12 = $1,731,324]

When this figure is adjusted for amounts booked during the test year and the K.U. jurisdictional factor, the transmission rental expense adjustment equals $920,573.

	$1,731,324	
less	589,789	booked

$1,141,535 X .806434 = $920,573 (Total amount to be allowed)

	$920,573
less amount allowed in March 18, 1983, Order	445,426
Additional amount allowed over that allowed in the May 18, 1983, Order	$475,147

APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 8624 DATED August 11, 1983.

The following rates and charges are prescribed for the customers in the area served by Kentucky Utilities Company. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the date of this Order.

RS RESIDENTIAL
Rural and Farm Residential Service

RATE

Customer Charge $ 2.75 per month
Plus an Energy Charge of:

5.410 cents per KWH for the first 100 KWH used per month
4.951 cents per KWH for the next 300 KWH used per month
4.540 cents per KWH for all in excess of 400 KWH used per month

FERS
Full Electric Residential Service

RATE

Customer Charge $ 3.75 per month
Plus an Energy Charge of:

4.597 cents per KWH for the first 1,000 KWH used per month
4.193 cents per KWH for all in excess of 1,000 KWH used per month

L.P.
Combined Lighting and Power Service

Energy Charge of:

3.154 cents per KWH for the first 500,000 KWH used per month.
2.905 cents per KWH for the next 1,500,000 KWH used per month.
2.775 cents per KWH for all in excess of 2,000,000 KWH used per month.

TO BE CONTINUED

END

OF

ROLL

START OF RETAKE

ROLL NO.: 7008432 24:1

TITLE OF RECORD SERIES: Public Service Commission - Original Orders
Case # 8845 May 20, 1983

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